

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

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CC:TEGE:EO2

PLR-147316-08

Date:

March 04, 2009

### LEGEND

Corporation =

State =

Statute =

Fund A =

Fund B =

Association =

Dear :

This is in reply to your letter dated October 31, 2008, requesting a ruling that the income of Corporation is excluded from gross income under § 115(1) of the Internal Revenue Code.

### FACTS

Corporation is a stock captive insurance company organized under the laws of State. As a captive insurance company Corporation provides reinsurance solely for the members of its two stockholders, Fund A and Fund B. Fund A provides its members with workers compensation insurance and Fund B provides its members with property/liability insurance. The members of Fund A and Fund B are municipalities, municipal authorities and certain other public entities in State. Each fund has received a ruling from the Service that its income is excluded from gross income under § 115 of the Code. Corporation proposes to amend its bylaws to provide that only a state, a political subdivision of a state, or an entity the income of which is excluded from gross income under §115 of the Code may become a participating employer in Corporation's reinsurance programs.

Corporation is governed by a board of five directors. Two directors are selected by the board of trustees of Fund A and two are selected by the board of trustees of Fund B. The four directors will elect a fifth director who will be a trustee of either Fund A or Fund B. The board of trustees of Fund A is the board of the state public retirement system. Fund B proposes to amend its charter documents to provide that its board of trustees is elected by its participating employers. In addition, it proposes to amend its bylaws to clarify that only an entity that is a political subdivision of a state or an entity the income of which is excluded from gross income may be a participating employer in Fund B.

Corporation is administered by a program administrator. Initially, the program administrator will be Association, a nonprofit corporation organized under section 501(c)(4). Corporation proposes to amend its bylaws to provide that its program administrator can be removed and replaced at any time and for any reason by its board of directors.

Corporation's income is derived from reinsurance premiums and investment income. Corporation's income will be used solely to provide reinsurance for its participating employers and pay for related administrative expenses. No part of the net earnings of Corporation inure to the benefit of any private person. Private parties do not participate in or benefit from the activities of Corporation.

Upon termination of Corporation, the directors will distribute the assets of Corporation to be used solely to provide reinsurance for its participating employers and pay for related administrative expenses. Corporation proposes to amend its bylaws to provide that in no case will the assets be distributed to an entity that is not a state, a political subdivision of a state or an entity the income of which is excluded from gross income under section 115 of the Code.

## LAW AND ANALYSIS

### Section 115

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utility or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign to properly conduct. In addition, pursuant to § 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under § 115 of the Code. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

Corporation's operations are limited to providing reinsurance to its participating employers, all of which are a state, a political subdivision of a state, or an entity the income of which is excluded from gross income under section 115 of the Code. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, Corporation performs an essential governmental function within the meaning of § 115(1) of the Code.

The income of Corporation accrues to its participating employers. No part of Corporation's net earnings inures to the benefit of any private person. In addition, upon the termination of Corporation, its remaining assets will be used to provide reinsurance to participating employers. In no case will the assets be distributed to an entity that is not a state, a political subdivision of a state or an entity the income of which is excluded from gross income under section 115 of the Code.

Based on the information and representations submitted by Corporation, we hold that, as of the date the proposed amendments described above are adopted, the income of Corporation is derived from the exercise of an essential governmental function and will

accrue to a state or a political subdivision thereof for purposes of § 115(1). Accordingly, Corporation's income is excludable from gross income under § 115(1) of the Code.

#### Section 6012

Section 6012(a)(2) and Treas. Reg. § 1.6012-2(a)(1) of the regulations provide, in part, that every corporation, as defined in § 7701(a)(3), subject to taxation under subtitle A is required to file an income tax return regardless of whether it has taxable income or regardless of the amount of its gross income.

Section 6012(a)(4) provides that every trust having for the taxable year any taxable income or having gross income of \$600 or over, regardless of the amount of taxable income, must file an annual income tax return. Section 7701(a) and § 301.7701-4 of the regulations define trust for purposes of § 6012.

If Corporation is classified as a trust for federal income tax purposes, no annual income tax return is required to be filed by Corporation pursuant to § 6012(a)(4) since any income realized by Corporation is excluded from gross income under § 115(1). However, if Corporation is a corporation, as defined in § 7701(a) (3), it will be required to file an income tax return pursuant to § 6012(a)(2).

No opinion is expressed on the classification of Corporation as a trust or corporation for federal tax purposes. No opinion is expressed concerning the federal tax consequences of the Corporation under any other provision of the Code other than those specifically cited above. This ruling concerns only the federal tax treatment of the Corporation's income.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that this ruling may not be used or cited as precedent.

In accordance with a Power of Attorney on file, we are sending a copy of this letter to your representative.

Sincerely,

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Sylvia F. Hunt  
Assistant Chief, Exempt Organizations  
Branch 2  
Division Counsel/Associate Chief Counsel  
(Tax Exempt and Government Entities)

Enclosures:

Copy of this letter  
Copy for § 6110 purposes